



CITY OF SANTA BARBARA

FINANCE COMMITTEE AGENDA REPORT

AGENDA DATE: October 7, 2008

TO: Finance Committee

FROM: Housing & Redevelopment Division, Community Development Department

SUBJECT: Request From The City Housing Authority For Loan Forgiveness

RECOMMENDATION:

That the Finance Committee review the request from the Housing Authority of the City of Santa Barbara and recommend that the Redevelopment Agency Board forgive the remaining balance of the Agency loan to the affordable apartments at 227 W. De la Guerra Street in the approximate amount of \$436,000.

DISCUSSION:

Background: In December, 1992, the Agency provided a loan in the amount of \$404,000 from affordable housing setaside funds to subsidize the construction of a 17-unit low-income senior affordable housing apartment complex at 227 W. De la Guerra Street. The developers were local architects Richard Bialosky and Detlev Peikert. The project received a substantial amount of financing from participating in the Low Income Housing Tax Credit program. The owner is "Cottage Gardens Associates, LTD.," a California Limited partnership in which Mr. Bialosky and Mr. Peikert serve as general partners. The project was completed in 1993, and, as was planned from the beginning, the project was master-leased to the Housing Authority of the City of Santa Barbara ("HASB") for 15 years. HASB has managed the project very efficiently for the past 15 years, providing an attractive living environment for 17 low-income senior households, and operating the project in accordance with the complex requirements of the Tax Credit program.

Purchase by HASB: The master-lease is about to expire, and, under the terms of the master lease, HASB now has the option to purchase the property from the partnership at an attractive price. HASB has given notice to the partnership that it intends to exercise its option. The close of escrow is set for on or around November 1, 2008. HASB intends to continue to hold and manage the property as affordable low-income senior rentals for the long term.

The purchase price under HASB's option is 95% of the appraised value of the property taking into account the rent restrictions under the Tax Credit program. This results in an option purchase price of \$1,629,250 (less than \$100,000 per unit).

There are two loans on the property with current balances as follows:

First trust deed loan:	920,000
Second trust deed loan (City RDA) balance:	<u>692,896</u>
Total loans on the property:	\$1,612,896

Pay-Down of Agency Loan: The Loan Agreement between the Agency and the owner and the Master-Lease agreement between HASB and the owner state that HASB is to set aside a portion of the rental income to make payments into an operating reserve account ("Reserve"). In the event that HASB exercises its purchase option at the end of 15 years, the documents provide that the entire balance of such Reserve be used to pay down the balance of the Agency loan.

The purpose of the Reserve was to fund any rental income shortfall that might result from payment reductions through the Section 8 Housing Choice Voucher program during the 15 year term of the master lease. Fortunately this project was not affected by such reductions, and the project built up the Reserve with payments totaling \$257,227. Thus the Agency will be receiving payment on its loan in this amount. The loan balance after this payment will be (\$692,896 less \$257,227 =) \$435,669.

Request for Loan Forgiveness: HASB has submitted a letter requesting that the Agency forgive the loan balance of approximately \$436,000. Staff supports this request for several reasons:

- HASB will continue to operate this property as affordable low-income rental housing for the long term; in exchange for this loan forgiveness, HASB will record a new 55-year City affordability covenant on the property
- Forgiving this debt will enable HASB to borrow a greater amount to be secured by the property, and HASB will use the proceeds of this borrowing to construct or rehabilitate other affordable apartments in the City
- This property was the subject of an understanding between City Housing Programs staff and HASB staff 15 years ago that staff would recommend forgiveness of the Agency loan upon HASB's exercise of their option to purchase

Unresolved Issue between the Owner and HASB: Staff has become aware that a dispute exists between HASB and the owner/seller regarding the characterization of the Reserve. Because this is a significant issue between the parties, staff feels that the Finance Committee and Agency Board should be informed. This dispute does not directly impact the Agency, because the parties don't dispute that the Reserve balance of approximately \$257,000 will be paid to the Agency to reduce the loan balance.

In brief, HASB believes that the Reserve is the property of HASB and, as such, it has the right to decide when it should be applied to pay down the Agency loan.. The owner, on the other hand, contends that the Reserve should be applied to pay down the Agency loan during escrow. This determination is important to both buyer and seller because the balance of debt on the property at escrow is used to determine the amount of cash to be received by the seller. If the owner's position is ultimately decided to be

correct, the owner would receive \$257,000 more cash at the close of escrow than if HASB's position is decided to be correct. If HASB prevails in the dispute, they will receive \$257,000 more cash at close of escrow than they would if the owner prevails.

BUDGET/FINANCIAL INFORMATION:

If the Agency Board forgives this loan, the Redevelopment Agency's affordable housing setaside fund will not receive the income from loan repayments that it otherwise might. HASB could repay this loan from future positive net cash flow to the project. The Agency would in turn loan or grant these loan repayments to projects of the Agency's choosing. However, the mission of HASB is in harmony with the goals of the Agency in allocating its housing funds, so the result in either case will be an increase in the supply of affordable housing in the City.

CONCLUSION:

The loan forgiveness requested by the City's Housing Authority will assist the Housing Authority with their mission to provide affordable low-income rental housing in the City, and will enable the Agency to extend the length of affordability controls on the property. Therefore, staff supports this request.

ATTACHMENT: Letter from the Housing Authority dated August 11, 2008

PREPARED BY: Steven Faulstich, Housing Programs Supervisor
David Gustafson, Assistant Community Development
Director/Housing and Redevelopment Manager

SUBMITTED BY: Paul Casey, Community Development Director

APPROVED BY: City Administrator's Office



HOUSING

AUTHORITY OF THE
CITY OF SANTA BARBARA

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August 11, 2008

HAND DELIVERED

Mr. David Gustafson, Housing and Redevelopment Manager
Community Development Department
City of Santa Barbara
630 Garden St.
Santa Barbara, CA 93101

RE: REQUEST FOR DEBT FORGIVENESS AS PART OF HOUSING AUTHORITY'S
PLANNED ACQUISITION OF COTTAGE GARDENS APARTMENTS—227 W. DE LA
GUERRA ST.

Dear Dave:

Pursuant to our recent conversations, the Housing Authority wishes to formally advise the City and the Redevelopment Agency (RDA) of its intent to execute its option to purchase the 17 unit senior apartment complex at 227 W. De La Guerra St. known as Cottage Gardens. As part of our purchase, we are hereby requesting debt forgiveness on a portion of the RDA's outstanding debt on the subject property. The amount of forgiveness requested is \$435,700. Once acquired, the City Housing Authority will operate the property in perpetuity as affordable, low rent senior housing.

As you will recall, Cottage Gardens was developed by Architects Richard Bialosky and Detlev Peikert under the Low Income Housing Tax Credit (LIHTC) program. It is currently owned by Cottage Gardens Associates, Ltd., a California limited partnership, in which Mr. Bialosky and Mr. Peikert serve as General Partners. Cottage Gardens was completed in December 1993 and subsequently master leased to the Housing Authority for 15 years. Our involvement was designed to help assure the investors—both the City/RDA as well as the limited partners—that the property would be well managed, comply with LIHTC program requirements, and maintain both its physical and fiscal integrity.

We have achieved all of those objectives and both the limited and general partners can now safely exit from their ownership position—something which the LIHTC program allows for after 15 years of successful operation. Under our Master lease, the Housing Authority has an option to purchase the property. We can execute our option as of October 25, 2008 and we have advised the owners of our intent to do so. Our intended closing date is on or around November 1, 2008. It is also the Housing Authority's intent and desire to hold the property as rental housing in perpetuity—noting that this goes far beyond the remaining 40 years of required compliance with the income and rent restrictions of the LIHTC program and the remaining 15 years required by the City's affordability covenant on the property.

To this end, we recently commissioned an appraisal of the property (via Santa Barbara Bank and Trust) by MT Associates (Mike Teobaldi) of Westlake Village. A copy of the appraisal is enclosed. It establishes fair market value of the property as of July 28, 2008 as follows:

Market Value Assuming Section 8 Rental Assistance	\$2,450,000
Market Value with Restricted Rents	\$1,715,000

Our option allows us to purchase the property at 95% of the Restricted Rents value shown above—which calculates to \$1,629,250; PROVIDED that this value is not less than the combined outstanding balances of the First Encumbrance and Second Encumbrance and Lessor's costs of sale. According to our information, the balance on the First Encumbrance remains at \$920,000. Since restructuring this First Encumbrance in late 2006, the owners have opted for interest only payments. In talking with City Finance Staff, we have estimated the balance on the Redevelopment Agency's loan (i.e. the project's Second Encumbrance) to be \$692,896 as of the end of October 2008. These two figures total \$1,612,896—and are less than our proposed purchase price as set by Mr. Teobaldi. Thus, the purchase price will be \$1,629,250.

It is also important to note that our Master Lease (Section 4.3.3) calls for us as Lessee to use all of the project's accrued Operating Reserve to pay down the RDA's Second Encumbrance should we exercise our Option to Purchase the Premises. We estimate that the project's Operating Reserve will be \$257,227 come the end of October 2008. This would pay down the outstanding balance on the RDA loan to \$435,669 (say \$435,700) as part of our purchase. This remaining amount, \$435,700, is the amount of debt forgiveness we seek from the Redevelopment Agency.

As stated earlier, our ownership will ensure the project's continued compliance with LIHTC restrictions for the next 40 years, City requirements for the next 15 years and, thereafter, the Housing Authority's own Non HUD program requirements for serving low income households at affordable rents in perpetuity. Thus, our subsidy request to the City/RDA to buy and preserve this property in perpetuity as affordable rental housing is \$435,700—or \$25,629 per unit.

On a related and historical note, I wish to remind all parties that this approach (i.e. RDA capital investment in early LIHTC projects pursued by private, for profit developers; Housing Authority master leasing of the completed project for excellence in management and program compliance; followed by an option to purchase in year 15; to be followed by RDA debt forgiveness as part of the Housing Authority's purchase) was the scenario laid out and agreed to (in general terms) back when these projects were structured.

I am happy to report that this scenario has played out extremely well. We have a well operated and still beautiful property in Cottage Gardens senior apartments capable of serving low income residents of Santa Barbara for decades to come. The Housing Authority's solid management has allowed for the project's operating reserve to grow each year, having never taken a draw on the reserve during the project's 15 years of operation. This has resulted in a projected balance of \$257,227 that can now be used to retire a good portion of the RDA's debt on the property.

Mr. David Gustafson
August 11, 2008
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In order to complete our purchase, be advised that the Housing Authority will be issuing a tax-exempt, mortgage revenue note in the not to exceed amount of \$1.5 million—noting that the probable amount of our borrowing will be closer to \$1.2 million. This will be used to cover the balance of our purchase price (\$1,629,250 less RDA debt forgiveness of \$435,700 = \$1.2 million).

If our funding/debt forgiveness request could be placed before the City Council/RDA Board in the next 30 to 45 days, it would be greatly appreciated. As always, we look forward to working with you and your staff on another important rental property acquisition and affordable housing preservation opportunity for the community.

Sincerely,

HOUSING AUTHORITY OF THE
CITY OF SANTA BARBARA

A handwritten signature in black ink, appearing to read "Rob Pearson", with a long horizontal flourish extending to the right.

ROBERT G. PEARSON
Executive Director/CEO

encl.

cc: Housing Authority Commission
S. Szymanski, Deputy Executive Director
R. Maccianti, Property & Development Director
R. Lawrence, Finance Director
R. Fredericks, Deputy Executive Director
S. Lowe, Lawyers' Title Company
Mark Manion, Esq., General Counsel, Price, Postel & Parma
Paul Thimmig, Esq., Bond Counsel, Quint and Thimmig